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PACIFIC  TELESIS  
Group-Washington

January 10, 1997

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

Mr. William F. Caton  
Acting Secretary  
Federal Communications Commission  
1919 M Street, NW, Room 222  
Washington, DC 20554

Dear Mr. Caton:

Re: CC Docket No. 96-45, *Federal-State Joint Board on Universal Service*

On behalf of Pacific Telesis Group, please find enclosed an original and six copies of its "Reply Comments" in the above proceeding.

Please stamp and return the provided copy to confirm your receipt. Please contact me should you have any questions or require additional information concerning this matter.

Sincerely,



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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

In the Matter of

Federal-State Joint Board on  
Universal Service

CC Docket No. 96-45

**REPLY COMMENTS OF PACIFIC TELESIS GROUP**

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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

In the Matter of

Federal-State Joint Board on  
Universal Service

CC Docket No. 96-45

**REPLY COMMENTS OF PACIFIC TELESIS GROUP  
ON JOINT BOARD'S RECOMMENDED DECISION**

I. **INTRODUCTION AND SUMMARY**

Pacific Telesis Group ("Pacific") hereby submits reply comments on the Joint Board's Universal Service recommendations. We make the following points:

- **Proxy Models.** The Commission should choose the Benchmark Cost Proxy Model ("BCPM")<sup>1</sup> that a consortium of companies, including Pacific, U S West and Sprint will present; however, proxy models should be used only to *disaggregate* the fund to small geographic units, and not to *size* the fund initially, because proxy models do not allow the recovery of current costs, including legacy costs;
- **Benchmark.** The revenue benchmark should not include services, such as access, "imputed access," or discretionary services; including such services will continue explicit

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<sup>1</sup> The BCPM also has been called the Best of Breed, or "BOB," model.

subsidies, cause the benchmark to be too high, and cause the support carriers receive from the fund to be too low;

- **Unbundling.** Purchasers of below-cost unbundled elements should not be eligible for the full amount of the subsidy attributable to the element; such a scheme will create a windfall for CLECs;
- **CCL/SLC.** While it is appropriate to consider access charge issues in the Access Reform docket, the Commission should ensure that the Subscriber Line Charge is not reduced;
- **Cost Recovery.** Carriers must be allowed to recover their costs of funding universal service through a surcharge on end user bills; if a surcharge is not allowed, the Commission must create a mechanism for carriers to pass on their universal service contributions in rates;
- **Low Income.** We continue to oppose a rule prohibiting us from disconnecting service for non-payment of toll calls, and cite commenters including the California Department of Consumer Affairs who agree;
- **Schools and Libraries.** The schools and libraries fund should not support the Internet or internal connections, and as a result the fund cap should be reduced; the “lowest corresponding price” should not be set below cost or based on dissimilar services, promotional rates or rates charged other schools and libraries; and schools and libraries should not be required to re-bid existing contracts;
- **Health Care.** The health care provisions should not be construed to require a particular speed of services such as T-1, buildouts, equalized distance charges, or toll free Internet access; and

- Interim Fund Administrator. The Commission should appoint NECA as the interim administrator of the schools, libraries and health care fund.

II. ANY UNIVERSAL SERVICE COST MECHANISM ADOPTED BY THE COMMISSION SHOULD ALLOW ILECS TO RECOVER THEIR ACTUAL COSTS

In its Recommended Decision, the Joint Board proposes a universal service funding mechanism that would allow eligible telecommunications entities to draw from a high cost fund based on the difference between an estimate of their costs, as determined by a cost proxy model, and a national average revenue benchmark. The record demonstrates, however, that adoption of this recommendation will fail to comply with the Telecommunications Act of 1996's ("1996 Act" or "Act") goal of ensuring sufficient universal service support for rural, insular, and high cost areas. As Pacific explained in its opening comments, the Joint Board's formulation cannot be squared with the statutory mandate because it will both substantially underestimate the costs of providing the services subject to universal service support and overestimate the revenue benchmark. The result will be a cost-compensation squeeze that will ultimately deprive rural, insular, and high cost areas of critical universal service support.

As discussed in detail below, Pacific's identification of numerous shortcomings in the Joint Board's recommendation for calculating universal service support requirements has been confirmed by many other commenters. These shortcomings render the Board's proposal inconsistent with both the requirements of Section 254 of the 1996 Act and the constitutional prohibition against uncompensated takings. Accordingly, Pacific urges the Commission to remain faithful to its universal service compact and to permit ILECs a reasonable opportunity to recover their legitimate investments and expenses incurred in the provision of ubiquitous telephone service to the public.

A. There Is Broad Agreement That ILECs Are Entitled To Recover Their Existing or "Legacy" Costs<sup>2</sup>

A substantial number of parties, including Pacific, properly urge the Commission to reject the Joint Board's proposal to use forward-looking costs as the measure for sizing the universal service fund. *See, e.g.*, Ameritech at 10-11, Bell Atlantic 12-13, BellSouth at 6-7, General Services Administration ("GSA") at 5, GTE at 25-32, Pacific at 6-8, SBC at 23-29, USTA at 12-13. For example, USTA points out that the "proper determination of the cost of providing universal service is the actual cost the incumbent LEC incurs to provide universal service." USTA at 12. Ameritech likewise explains that "[a]ctual costs are preferable because the carrier would be compensated based on fact." Ameritech at 10-11.

Bell Atlantic further states that "there is no need to use a proxy when actual figures are available," and that "[t]he Joint Board itself even recommended use of actual loop costs, rather than a proxy, to determine whether schools and libraries are in 'high-cost areas' for calculating education support. There is no reason not to use actual costs for calculating high cost support as well." *Id.* at 12-13. Indeed, "use of actual costs provides better data than can any theoretical proxy model, no matter how well designed."<sup>3</sup> *Id.* at 13. Reliance on LECs' existing, real world costs to size the fund simply makes sense in the context of a program with the goal of removing existing real world impediments to telephone subscribership.

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<sup>2</sup> Legacy costs are the costs associated with recovery (and in the interim, return on investment) for past investments in plant and equipment previously found to be used, useful and includable in the ratebase for the purposes of regulated telecommunications services.

<sup>3</sup> Pacific submits that the use of a proxy model is appropriate to allocate costs among subunits to study areas, because actual costs are not available for these smaller territories.

Commenters also demonstrate that the alternative put to sizing the fund forward by the Joint Board -- a forward-looking cost scheme -- conflicts with the 1996 Act. As SBC emphasizes, "[t]here is nothing in the Act that requires or even suggests that Congress intended that the longstanding use of actual costs was to be jettisoned through Section 254." SBC at 24. To the contrary, the statute expressly mandates that any universal service funding mechanism be "specific, predictable, and sufficient . . . ."<sup>4</sup> For example, cost figures based upon a rapidly evolving "forward-looking" technological mix can be neither "specific" nor "predictable." Rather, such figures will be subject to all of the uncertainties and potential for manipulation inherent in any business forecast or other attempt to predict the future.

Most importantly, "in order to be 'sufficient,' the plan must provide a level of funding which would cover the necessary costs of universal service providers." GTE at 26. However, in the telecommunications industry, where there is already a broad assumption of declining costs, the application of forward-looking costs necessarily will underestimate the actual costs ILECs incurred in providing service to high cost areas. The result will be an undersized fund that inadequately compensates ILECs in violation of the "sufficiency" mandate. Moreover, an inadequate universal service fund will act as a disincentive to facilities-based competition, particularly in high-cost areas, thereby denying consumers in those areas the benefits of competition contrary to the goals of the 1996 Act.

Moreover, the record reveals substantial agreement that exclusive reliance on a model that employs a forward-looking cost scheme for quantifying universal service requirements will result in an unlawful taking. Pacific and a number of other commenters demonstrated that a forward-looking

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<sup>4</sup> 47 U.S.C. § 254(b)(5).

cost model breaks the long-standing contract between ILECs and regulators to bring quality service to consumers at affordable prices. *See, e.g.*, GTE at 31, Pacific at 6-8, SBC at 23. As USTA explains, failure to allow ILECs to recover their actual costs would constitute a confiscatory taking "because incumbent LECs assumed obligations to serve, including the provision of universal service, in return for the regulator's assurance that the utilities would have the opportunity to earn a competitive return on invested capital, along with the compensation for the full cost of providing service." USTA at 12.

The Joint Board's proposal essentially asks the Commission to disregard this bargain as well as the ILECs' constitutional right to be fully compensated. This result should not be countenanced. As SBC correctly observes, "[a]bsolutely nothing in the Act has changed or could have changed those constitutional standards [entitling ILECs to a reasonable opportunity to recover their prudently incurred expenses and to earn a reasonable return], nor relieves the Commission or the States from meeting those requirements." SBC at 23.

**B. If the Commission Nonetheless Insists on Using a Forward-Looking Cost Model to Size the Universal Service Fund, It Must Incorporate Three Critical Elements: (1) An Additive for Legacy Costs; (2) Reliance on Actual Cost Data; and (3) Use of Forward-Looking Demand Figures**

Pacific supports the use of proxy cost modeling to distribute the universal service fund to small geographic units. Using the model in this manner allows for proper disaggregation of the fund in small areas, which is necessary for proper distribution of the fund, because there are no actual cost figures for small geographic units such as Census Blocks. However, proxy models should not be used to determine the size of the fund; here, actual or current costs should be used, because forward-looking costs neither compensate ILECs for their legacy costs, nor capture all of the current costs ILECs incur in providing service. If a proxy

model nonetheless is used to size the fund, it must allow for recovery of legacy costs and be based on current costs, as we explain below.

1. Any Forward-Looking Cost Model Adopted by the Commission Should Allow ILECs To Recover Past Costs

If the Commission decides *to size the fund* based on a cost model which uses forward-looking costs, rather than historical costs, it should implement a transitional mechanism to permit the recovery of legacy costs. Pacific proposes that the Commission establish a six-year transitional mechanism to compensate ILECs for their legitimately incurred costs.<sup>5</sup> During this period, ILECs would be permitted to withdraw amounts from the high cost fund based on their legacy costs. However, CLECs that win over ILEC customers would not be eligible to make withdrawals from this portion of the fund because they have no legacy costs to recover. Implementation of such a transitional mechanism would strike a reasonable balance by allowing ILECs to recover their legacy costs without disrupting competition or harming consumers.

2. Any Forward-Looking Cost Model Adopted by the Commission Should Use Actual ILEC Data To Predict Costs

Even among those commenters who support use of a forward-looking cost model to calculate ILEC costs, there are conflicting views on the types of costs to be used as inputs to the model. As discussed above, Pacific and a host of others generally object to the use of forward-looking costs to size the universal service fund. However, should the Commission nonetheless decide to adopt the Joint Board's suggestion and select a model that employs forward-looking costs to size the fund, the model

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<sup>5</sup> For a complete discussion of Pacific's proposed transitional mechanism, see Pacific's opening comments at 8-10.

should be based on actual ILEC data, not the phantom inputs associated with a hypothetical carrier. *See, e.g.,* GSA at 5, GTE at 26-31, Pacific at 10-13, USTA 12-15.

Using ILECs' actual cost data will help ensure a more accurate and reliable prediction of costs. There is simply too much room for error -- and manipulation -- when using forward-looking costs based on the "least-cost technology" as recommended by the Joint Board. *See* ¶ 277. A forward-looking cost model based on ILECs' current costs<sup>6</sup> would permit ILECs to recover their true future costs, not simply those costs associated with some hypothetical carrier. As USTA points out, "[i]n a typical proxy model, workers are always healthy, equipment always functions and all residences and businesses are exactly alike and efficiently located. Not surprisingly, the costs of a hypothetical network may not bear a strong resemblance to actual costs."<sup>7</sup> Unlike hypothetical costs, forward-looking costs based on current expenditures at least would be directly related to actual ILEC networks and to the realistic costs of placing and operating those networks.

The Commission should not seek to analogize the use of forward-looking costs in the universal service context to the use of such costs in the *First Interconnection Order*.<sup>8</sup> Any such comparison is illogical. Pacific and others have already shown that basing the prices of interconnection and unbundled network elements on the forward-looking costs of the "least-cost technology" constitutes a confiscatory taking.<sup>9</sup> A model that employs forward-looking costs to

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<sup>6</sup> Current costs are the costs of the ILECs' networks actually deployed and operating.

<sup>7</sup> USTA at 12 (quoting Lee Schmidt, Chairman, USTA "The Universal Service Recommendation: Not Ready for Prime Time," before the National Association of Regulatory Utility Commissioners, Annual Convention, Nov. 19, 1996).

<sup>8</sup> *Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98 (rel. August 8, 1996) ("*First Interconnection Order*").

<sup>9</sup> *See* Pacific's Reply Comments, CC Docket No. 96-98, Phase I, at 29-32 (filed May 30, 1996).

determine universal service support is just as unlawful as one used to determine the prices of interconnection and unbundled network elements. Both lead to the same result -- depriving ILECs of a reasonable opportunity to recover their legitimately incurred expenses.

Furthermore, interconnection and universal service, though interrelated, are different regulatory programs with divergent -- and potentially conflicting -- goals. The Commission's rationale for basing pricing on forward-looking costs in the interconnection proceeding was the need to "jump start" competition. Even assuming, *arguendo*, the reasonableness of that goal in the interconnection context,<sup>10</sup> it is simply inapplicable in the context of universal service, where the goal is to provide telecommunications services to all consumers at affordable rates.

It follows that the Commission should similarly reject the continued urgings of AT&T and MCI to adopt the Hatfield model. *See, e.g.*, AT&T at 13-14, MCI at 3-7. The Joint Board has already explained its refusal to recommend any of the existing models, including Hatfield. ¶¶ 268, 279. Moreover, a number of commenters, such as SBC, USTA, and U S West, have thoroughly explored the patent deficiencies in the Hatfield model. *See, e.g.*, Pacific at 15, SBC at 26-29, USTA at 13-14, U S West at 33-41. Indeed, U S West's analysis revealed the following shortcomings in the Hatfield model:

- I. It artificially depresses costs.
- II. It understates drop costs.
- III. It understates the length and, hence, the costs of distribution facilities.
- IV. It understates the percentage of buried facilities.
- V. It understates the costs of building and installing network structures.
- VI. It understates equipment prices and overstates vendor discounts.
- VII. It uses unrealistically long depreciation lives for network equipment.
- VIII. It understates taxes.
- IX. It understates the cost of capital.

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<sup>10</sup> Pacific submits that such below-cost pricing requirements cannot be justified with respect to either interconnection or universal service.

- X. Because it manipulates and understates costs in this manner, it lacks any credibility.

U S West at 33-41. In light of these deficiencies, the current workshops, and ongoing efforts to develop a "best of breed" proxy model (the BCPM) that takes the best features of BCM2 and CPM, the Commission should again deny requests to adopt the flawed Hatfield model. *See, e.g.,* Pacific at 13, USTA at 15.

3. Any Forward-Looking Cost Model Adopted by the Commission Should Use Forward-Looking Demand

Finally, if even forward-looking costs are to be adequately recovered, unit prices must be computed based on future demand. *See* Pacific at 14. However, since none of the models attempts to predict forward-looking demand, actual, current costs and demand should be used instead.

One of the more obvious flaws of the Hatfield model is that it uses current demand to compute future unit prices. As Pacific explained in its opening comments, this methodology wrongfully assumes that current demand will remain constant, notwithstanding the fact that competition is certain to reduce demand significantly for incumbents' services in the future.<sup>11</sup> When demand drops, fixed costs remain the same, thereby increasing per unit costs. Thus, use of excessive demand figures will result in erroneously low per-unit costs just as readily as will reliance on improper cost figures.

It follows that the cost and demand figures employed in any cost model must be comparable, *i.e.*, forward-looking costs must be paired with the corresponding forward-looking demand figures, or, more logically, current costs and current demand should be used instead of proxy

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<sup>11</sup> The level of costs will also decline as demand diminishes, but it will not decline in direct proportion to demand decreases because economies of scale will be lost and plant will be stranded.

models to size the fund. Only by matching cost and demand will the fund adequately cover unit support costs.

III. THERE IS SUBSTANTIAL AGREEMENT THAT THE NATIONWIDE BENCHMARK SHOULD EXCLUDE REVENUES FOR DISCRETIONARY AND ACCESS SERVICES

We object to the Joint Board's revenue benchmark, which is too high and thus will result in support that is too low. The Joint Board proposed to calculate the amount of universal service support a carrier receives based upon the difference between a cost estimate and a revenue benchmark. The Joint Board would establish this nationwide pricing benchmark based on average revenues-per-line, to be calculated by dividing all local, discretionary, and access revenues by the number of loops served. ¶ 310. Although Pacific and other parties support basing the benchmark on average revenues-per line, we object to the inclusion of revenues from discretionary and access services in the formulation. *See, e.g.,* Pacific at 16-18, Sprint at 18-20, USTA at 10-11. Pacific further submits that it is inappropriate to prescribe a fixed dollar benchmark, because it would not be compensatory in all cases and does not take into account differences among regions. *See* U S West at 28-30.<sup>12</sup>

The only way to ensure that the funding mechanism is sufficient, predictable, and explicit as required by the 1996 Act is to develop a benchmark that includes only those services supported by the universal service fund, rather than a laundry list of other services. Otherwise, as GTE explains, "the method proposed would dramatically underestimate the total need for support." GTE at

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<sup>12</sup> The Commission should also reject Time Warner's proposal to freeze the revenue benchmark. A static benchmark is wholly inappropriate because the adequacy of universal service support depends on a flexible benchmark that can change as revenues fluctuate over time. *See* Time Warner at 27-28.

19. Accordingly, the Commission should reject the Joint Board's proposal to create an inflated revenue benchmark that undercompensates ILECs.

A. The Cost Model Does Not Contain Costs Associated With Discretionary or Access Services

The Joint Board apparently included discretionary and access services in its universal service equation because it incorrectly assumed that a cost proxy model would include costs associated with providing discretionary and access services. Pacific at 16. Contrary to the Joint Board's assumption, commenters agree that a properly developed cost model will include only the costs of the services studied. *See, e.g.*, Pacific at 16-17, USTA at 11. For example, the BCPM excludes costs associated with discretionary and access services. This is appropriate because, logically, the model should address only those costs eligible for universal service support. Therefore, to maintain consistency between the cost and revenue components of the universal service support equation, the nationwide benchmark should exclude discretionary and access revenues.

B. The Record Demonstrates That Including Discretionary and Access Services in the Benchmark Would Violate the 1996 Act By Perpetuating Implicit Subsidies

Several commenters convincingly describe how including discretionary and access services in the benchmark would perpetuate existing implicit subsidies in violation of the 1996 Act's mandate that support be predictable and explicit. *See, e.g.*, GTE at 19-20, Pacific at 17, SBC at 34, USTA at 10-11, U S West at 29. Even if the Commission elects to include the costs of providing discretionary and access services in the cost model, including the corresponding revenues in the benchmark indisputably will maintain the existing implicit subsidy system, which is funded in large

part by rates for access and discretionary services that are set above the true economic costs of those offerings.<sup>13</sup>

In fact, under the Joint Board's proposal, a carrier would be denied recovery from the high cost fund even if it did not or could not sell the level of discretionary and access services equivalent to that included in the benchmark. Thus, a carrier would be precluded from removing the subsidy elements from its own rates, even if it could successfully market the benchmarked quantity of such services. Such a result does not comport with the 1996 Act.<sup>14</sup>

Pacific urges the Commission to consider carefully GTE's analysis of the Joint Board's benchmark proposal. First, GTE correctly points out that the high rates established for many of these services "cannot be sustained at current levels in a competitive market and will come down in the near future . . . . Therefore no carrier could reasonably expect that it could rely on the current level of revenue from those services, even on average." GTE at 20-21. Second, GTE demonstrates that, because the demand for access and vertical services is much more elastic than for local services, "a carrier that targets customers with high levels of usage can enjoy revenue much greater than the average." *Id.* at 21. Consequently, ILECs, which have carrier of last resort obligations and are constrained in their ability to target consumers, will be placed at a competitive disadvantage. *Id.* Finally, GTE explains that "the mere fact that a carrier provides local service to a customer does not

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<sup>13</sup> As SBC emphasizes, "[i]ncluding revenues from services other than those encompassed by the universal service definition perpetuates the reliance on implicit support to maintain universal service. Such action is in direct conflict with the intent of the Act, specifically Section 254(e)." SBC at 34. *See also* U S West at 29 ("inclusion of vertical services revenues continues to incorporate an implicit subsidy flow into local loop investment.")

<sup>14</sup> Teleport's suggestion that inclusion of additional service revenues is somehow necessary to reflect the value of a basic service customer to a carrier is simply irrelevant to this statutory analysis and fails to address the disconnect between these revenues and the supported services. *See* Teleport at 6-7.

guarantee it 'follow-on' revenues from other services," *id.* at 21, and that, because the amount of revenue from discretionary and access services varies from one geographic to another, "a level of support calculated on the basis of a nationwide average will simply be insufficient in many areas." *Id.* at 22.

For all of these reasons, Pacific urges the Commission to adopt a nationwide average revenue-per-line benchmark that includes only those revenues collected from residential end-users for the provision of basic exchange services (*i.e.*, basic exchange and EUCL revenue). Many commenters support Pacific's position. *See, e.g.*, MCI at 8-10, Sprint at 18-20, U S West at 29-30. For example, Sprint properly points out that "[t]he universal service fund is intended to include only basic local service, and thus the benchmark figure should include only basic local service revenues." Sprint at 20.

For the same reasons, the Commission should reject all requests to further expand the revenue base. For example, the Ad Hoc Telecommunications Users Committee and Time Warner both ask the Commission to include revenues from yellow pages in the nationwide benchmark.. *See* Ad Hoc Committee at 11-14, Time Warner at 21-23. The Joint Board previously, and properly, ignored this proposal. *See* Ad Hoc Committee at 12. Given that the Joint Board's recommendation to include revenues from discretionary and access services in the benchmark is already overly broad, adding the revenues from yellow pages and other services is unwarranted and would only exacerbate the legal and practical failings discussed above.

IV. **CLECS WHO PAY BELOW COST PRICES FOR UNBUNDLED ELEMENTS SHOULD NOT BE ALLOWED TO RECEIVE THE FULL SUBSIDY ATTRIBUTABLE TO THOSE ELEMENTS**

Some commenters claim they should be allowed to purchase unbundled elements at TELRIC prices pursuant to the Commission's (now stayed) *First Interconnection Order*, and then

receive the full subsidy attributable to those elements. *E.g.*, AT&T at 3, Sprint at 21. We oppose this position; it is not competitively neutral, and will give CLECs a windfall not intended by the Joint Board. Rather, in the unbundling context, ILECs' competitors should pay the actual cost of the unbundled elements -- an amount which includes recovery for legacy costs -- and receive the subsidy associated with that element, as developed by a proxy model that takes actual or current costs, and legacy costs, into account.

If, for example, a CLEC pays \$26 for an unbundled element, it should be entitled to support amounting to the difference between \$26 and its revenues attributable to the customer, and the ILEC should receive the remaining subsidy attributable to the line. *See Pacific* at 26 (charting allocation of subsidy in unbundling context), *SBC* at 22, *USTA* at 23-25, 31. The CLEC should not be allowed to pay less than cost for the element, and receive the full subsidy attributable to that element as determined by the proxy model. That is, in no situation should a CLEC receive a greater subsidy than the cost it incurs to provide an element less the revenues it receives for providing service including that element.

V. **IT IS APPROPRIATE TO DEAL WITH ACCESS CHARGE ISSUES IN THE ACCESS REFORM DOCKET; REGARDLESS OF WHERE IT DEALS WITH THE ISSUES, THE COMMISSION SHOULD NOT REDUCE THE SLC CAP**

We agree with several commenters that urge the Commission to deal with the access charge issues the Joint Board raises in the pending access reform docket.<sup>15</sup> *E.g.*, *CompTel* at 17-18, *MFS* at 34-36, *Bell Atlantic* at 23. Regardless of where the Commission resolves issues related to the CCL and the SLC, however, it should not reduce the SLC to account for changes in the Long Term

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<sup>15</sup> *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, et al.*, CC Docket Nos. 96-262, 94-1, 91-213 & 96-263, *Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry*, FCC 96-488 (rel. Dec. 24, 1996) ("*Access Reform NPRM*").

Support subsidy or in the regulatory treatment of payphones, or for other reasons. USTA at 19, Ameritech at 15-17, WorldCom at 35-38, AT&T at 12-13, Bell Atlantic at 23.

Indeed, as SBC points out, the Commission has already ordered removal of interstate pay telephone support to be offset fully by reductions to the interstate CCL. SBC at 36 (citing CC Docket No. 96-128). There is no basis for altering the decision to offset the CCL, rather than both the CCL and SLC charges, for the payphone reduction. The Commission's suggestion in its *Access Reform NPRM* (at ¶¶ 64-65) that the SLC should not decrease, and indeed should increase in some cases, most closely reflects the appropriate approach to the SLC.

VI. THE COMMISSION SHOULD ALLOW CARRIERS TO RECOVER THEIR UNIVERSAL SERVICE CONTRIBUTIONS FROM END USERS

Several commenters took issue with the Joint Board's suggestion that carriers should not be allowed to recover their universal service contributions from end users; we second those comments, and support an end-user surcharge as a means of recovering fund contributions. WorldCom at 40-41, PCIA at 3, 28-31, MFS at 12-13, 26, CompTel at 14-17. There is no basis to require carriers' shareowners to fund universal service for all telecommunications carriers, as Chairman Hundt suggested when he stated that it "wouldn't be 'the right policy or the right way to go' for carriers to pass the assessments on to consumers"<sup>16</sup> after the Joint Board issued its recommendation.

Rather, carriers should be allowed to recover their universal service contributions through a surcharge on end users. If the Commission does not permit a surcharge, it should allow carriers to recoup their contributions through adjustments in their rates. As the California Department of Consumer Affairs points out, contributions should clearly be specified and apparent to consumers.

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<sup>16</sup> "Joint Board Wants \$2.5 Billion Education Fund; Disagreement Surfaces Over Intrastate Revenues," *Telecommunications Reports*, November 11, 1996, at 2.

Cal. Dep't of Consumer Aff. at 38-40. In keeping with the concept that consumers have a right to know what they are paying to support universal service, the Commission should expressly authorize carriers to pass costs on to their end users either as a separate line item on a bill, or by increasing the price of an existing service to cover support payments. *See also* California Public Utilities Commission ("CPUC") at 13-15 (supporting explicit end user surcharges).

VII. WE AGREE WITH THOSE WHO OPPOSE A NO-DISCONNECT RULE FOR CUSTOMERS WHO FAIL TO PAY TOLL CHARGES

We opposed the Joint Board's proposal to preclude carriers from disconnecting Lifeline customers who failed to pay their toll charges, and are therefore heartened to discover that commenters such as the California Department of Consumer Affairs support our position. The Department states "Precluding all disconnection for Lifeline customers on the basis of non-payment of toll charges will doubtless generate losses that all other bill-paying customers will bear. . . . Such a program would provide Lifeline customers with undue advantage vis-a-vis other consumers, and would generate needless losses which other people would be forced to bear." Cal. Dep't of Consumer Aff. at 42; *see also* Ameritech at 14-15, MCI at 12-13, SBC at 8-9, USTA at 33, WorldCom at 24, NY Dep't of Public Service at 14-15 (questioning link between Lifeline participation and subscribership levels, and urging study of the issue). The Commission should reject the no-disconnect rule.

VIII. THE COMMISSION SHOULD NOT INCLUDE THE INTERNET AND INTERNAL CONNECTIONS AMONG SUPPORTED SERVICES, REQUIRE AN INAPPROPRIATE LCP, OR REQUIRE REBIDDING OF EXISTING CONTRACTS

The comments regarding schools and libraries merit response in four areas. We 1) oppose including Internet and internal connections among eligible services; 2) oppose setting the pre-discount price (the "lowest corresponding price" or "LCP") based on dissimilar prices, TELRIC,

the rates charged other schools and libraries, or promotional prices; 3) and oppose abrogation of existing contracts by requiring schools and libraries to re-bid them.

A. Because Internet and Internal Connections Are Not Supportable Services, the Fund Cap Should Be Reduced Below \$2.25 Billion

We agree with numerous commenters who urge that the \$2.25 billion schools/libraries fund cap be reduced. Bell Atlantic at 21, Citizens for a Sound Economy at 11-12, NYNEX at 39, Citizens Utilities at 17, MFS at 30-31. Our reasoning for supporting reduction is simple: the Internet and internal connections are not appropriately included among the supported services. Without the considerable expense associated with these services, there is no need for a fund of such magnitude.

1. Imposing Universal Service Contribution Requirements on Carriers, While Allowing Unregulated Entities to Collect From the Fund, and Supporting Unregulated Services Transforms the Fund Contributions Into An Impermissible Tax

In addition to the reasons we cited in our opening comments, we agree with the commenters who state that the inclusion of the Internet and internal connections -- goods and services that are *not regulated* by the Commission -- would improperly convert the assessment on telecommunications carriers into a *tax*. See SBC at 46-48, citing *South Carolina v. Block*, 717 F.2d 874, 887 (4th Cir. 1983), *cert. denied*, 465 U.S. 1080 (1984) (the distinction between a fee and a tax is whether “regulation is the primary purpose” of the statute; tax involves raising revenue for “general welfare”); MFS at 31.

Any assessment levied on telecommunication service providers or customers for the support of unregulated services and unregulated service providers such as Internet providers, equipment manufacturers and inside wiring contractors, would serve no *regulatory purpose*, but instead further *a broader governmental purpose*. However, fees and other assessments which serve

broad governmental purposes are impermissible taxes. *South Carolina v. Block*, 717 F.2d at 887; *see also* AirTouch at 21 (“funding for internal connections should come from general taxes, not those levied specifically on the telecommunications sector.”).

If the Commission is actually imposing a tax, it is doing so without proper authority, as SBC points out: “In delegating legislative authority, Congress must provide ‘an administrative agency with standards guiding its actions such that a court could “ascertain whether the will of Congress has been obeyed.”’” SBC at 47, citing *Skinner v. Mid-America Pipeline*, 490 U.S. 212, 218 (1989). Here, Congress’ will was not to impose a tax: the 1996 Act originated in the Senate, whereas taxing bills must originate in the House. U.S. Const., Art. I, Sec. 7 (“[a]ll Bills for raising Revenue shall originate in the House of Representatives. . . .”).

Had the House interpreted the Senate-passed bill as authorizing the Commission to impose and collect a tax, it would have informed the Senate that it was acting in excess of its authority by returning the bill to the Senate -- a process known as “blue slipping.” The House has a long and well-established history of carefully guarding its constitutional prerogative regarding the origination of tax bills. That the House did not reject the Senate bill makes clear that it did not interpret the bill as containing any tax provisions. It is also highly unlikely that the Senate, anticipating the reaction of the House, would not have attempted to send to the House a bill containing as broad a delegation of taxing authority as is implied in the Joint Board recommendation.

To turn the Act into a tax measure -- by requiring one set of providers to pay into the fund and allowing an altogether different set of entities to take from it, as well as using the monies collected to support goods and services not regulated by the Commission -- thus is contrary to the will of Congress and must be rejected.

2. Universal Service Funding To Encourage Internet Access Must Be Limited To Support For Only Telecommunications Services

a) Internet Access Service May Not Be Directly Supported

There is widespread agreement in the comments that Internet access service is an information service and, thus, that Internet access service providers are not legally eligible for support from the universal service fund for provision of this service to schools and libraries.<sup>17</sup> Even some parties who express pleasure with the Joint Board's recommendation that Internet access services receive support express reservations concerning the legality or practicality of this approach. For instance, ITAA (at 3) expresses "concern that using universal service revenues to fund information services -- including Internet access service -- would exceed the Commission's authority under Section 254(c)(1), which defines universal service as 'an evolving level of *telecommunications* services.'"<sup>18</sup> We explained in detail in our comments why direct discounts on Internet access service would be both illegal and contrary to the public interest.

The slippery slope that the Joint Board has recommended is evidenced by AOL's attempt to broaden the types of Internet services eligible for support. AOL objects to the Joint Board's limitation that the Internet access to be funded would include only "minimal content." AOL at 3. AOL states, "Having made the decision to subsidize access to Internet content, it makes no sense to restrict the amount of additional content which may be bundled with Internet access . . . ." *Id.* at 4.

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<sup>17</sup> *E.g.*, Ameritech at 18-19, AT&T at 18-21, BellSouth at 26-27, CPUC at 3, 10-16, GTE at 89-96, MCI at 18, NYNEX at 40, Pacific at 37-44, SBC at 43-45, 49-50. The Interactive Services Association does not take a position on the question of support, but states at page 2 that "Internet access service falls within the definition of an 'information service,' and both the Joint Board and the Commission have found that information services are not telecommunications services."

<sup>18</sup> *See also* Internet Consumers at 7, Netscape at 6.